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IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

On Appeal from the United States Court of Appeals for the Fifth Circuit

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BRIEF OF EDISON ELECTRIC INSTITUTE AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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TABLE OF CONTENTS

	Page
OPINION BELOW	1
INTEREST OF EDISON ELECTRIC INSTITUTE	1
STATEMENT OF THE CASE	4
SUMMARY OF ARGUMENT	7
ARGUMENT	8
THE OPINION BELOW VIOLATES THE PREEMPTION DOCTRINE OF *NANTAHALA* AND *MP & L*, THREATENING THE PROPER AND WELL-ESTABLISHED RELATIONSHIP BETWEEN FEDERAL AND STATE/LOCAL ELECTRIC UTILITY REGULATION	8
A. Under *Nantahala*, FERC's rate order triggered the principle of federal preemption, removing prudence from the Council's purview	9
B. *MP & L*, reiterates the *Nantahala* prohibition of the Council's "prudence" review of NOPSI's practices	10
C. *Nantahala*'s limited exception to FERC preemption simply does not apply in this case	11
D. FERC is the only appropriate forum for the resolution of interstate cost allocation issues	13
CONCLUSION	14

TABLE OF AUTHORITIES

CASES:	Page
City of New Orleans v. FERC, 875 F.2d 903 (D.C. Cir. 1989), *cert. denied sub nom. Miss. v. FERC*, —— U.S. ——, 110 S.Ct. 1805 (1990)	5
Maine Public Utilities Comm'n v. Maine Yankee Atomic Power Co., cert. denied, —— U.S. ——, 59 U.S.L.W. 3527 (No. 90-1194, June 24, 1991)	13
Middle South Energy, Inc., Initial Decision, 26 FERC ¶ 63,044 (1984), *aff'd*, Opinion No. 234, 31 FERC ¶ 61,305 (1985), *decision on reh'g*, Opinion No. 234-A, 32 FERC ¶ 61,425 (1985)	5, 8, 12
Mississippi Industries v. FERC, 808 F.2d 1525 (D.C. Cir.), *vacated in part*, 822 F.2d 1104, *cert. denied sub nom. Arkansas Public Service Comm'n v. FERC*, 484 U.S. 985 (1987)	5
Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354 (1988)	*passim*
Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986)	*passim*
New Orleans Public Service Inc. v. The Council of the City of New Orleans, 491 U.S. 350 (1989)	6
System Energy Resources, Inc., Opinion No. 292, 41 FERC ¶ 61,238 (1987); Opinion No. 292-A, 42 FERC ¶ 61,091 (1988)	5

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OPINION BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reproduced in the Joint Appendix ("J.A.") to the Petitioner's Brief (J.A. 11-33) and is reported at 911 F.2d 993.

INTEREST OF EDISON ELECTRIC INSTITUTE

Edison Electric Institute (EEI)[1] is the association of the nation's investor-owned electric utility companies. Its members serve 96 percent of all customers served by

[1] EEI has obtained consent from Petitioner and Respondents to file this brief. EEI has filed those consents with the Clerk of the Court concurrently with the filing of this brief.

the investor-owned segment of the electric utility industry. They generate approximately 78 percent of all the electricity used in the country, and serve 74 percent of all ultimate electricity consumers in the nation.

The ability of many EEI members to provide reliable electric service under rates that are just and reasonable to their customers and to their shareholders depends heavily on a regulatory structure in which the Federal Energy Regulatory Commission (FERC), regulating rates for wholesale electricity transactions in interstate commerce, and state or local regulatory bodies, regulating rates for retail electricity sales, operate compatibly. Only FERC can provide the neutral forum which is essential to the resolution of regulatory disputes involving the interstate allocation of costs among affiliates of a utility system which operate in more than one state.

New Orleans Public Service Inc. (NOPSI), its operating company affiliates, and their common parent Entergy Corporation (formerly Middle South Utilities, Inc.) are all members of EEI. Together, they form a fully coordinated and highly integrated electric utility system which operates in four states. They are subject to regulation by FERC for wholesale electricity transactions, and by four state regulatory commissions and the Council of the City of New Orleans ("Council") for retail transactions. Thus, the operating affiliates of Entergy are subject to the rate regulation of six different jurisdictions. Their ability to provide reliable electric service is heavily dependent upon harmonious decisionmaking within that regulatory environment.

Most EEI members obtain some portion of their total electric supply through interstate wholesale transactions subject to rates regulated exclusively by FERC. Many of these companies, such as NOPSI, participate in multistate "power pools" with provision for reciprocal wholesale exchanges and sales. Others have invested in jointly-owned generation projects which supply power at wholesale to the joint-owners. Moreover, many utilities provide service in more than one retail jurisdiction.

This Court has recognized FERC's central role in the regulation of wholesale and interstate transactions, and has applied the doctrine of federal preemption in the context of electric utility regulation to ensure the continued ability of FERC to function as a neutral forum to resolve regulatory disputes regarding the allocation of costs among utilities in different states. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) (retail rates of affiliated utilities must reflect FERC cost allocations) ("*Nantahala*"); *Mississippi Power & Light Co. v. Mississippi ex rel Moore*, 487 U.S. 354 (1988) (a FERC determination of the allocation of costs of a generating unit among affiliates of a utility system, where parties were afforded an opportunity to address the prudence of the transaction, preempts a subsequent attempt by a state regulatory commission to exclude or trap such costs from retail rates on grounds of imprudence) ("*MP & L*").[2]

This case raises again the question of whether a state or municipal regulatory body may use its retail ratemaking authority to effectively prevent a utility from recovering, thereby "trapping," a FERC allocation of wholesale costs among affiliated utilities serving different jurisdictions. This case arose from the same FERC allocation of wholesale costs among the operating companies of the Entergy Corporation system that this Court considered in *MP & L*.

The opinion of the court below threatens the foundation of the nation's interwoven electric utility regulatory process. This Court's decision in *MP & L* confirmed that there is a "bright line" between FERC and state or local jurisdiction under the Federal Power Act and the

[2] EEI submitted *amicus curiae* briefs supporting similar positions in each of those cases.

Supremacy Clause of Article VI of the Constitution, and that this federal preemption means that state and local regulatory commissions cannot "trap" the recovery of costs which were allocated among affiliates by FERC. The opinion of the court below violates this principal of preemption. It is apparent that this Court's recent *Nantahala* and *MP & L* decisions need to be reiterated.

EEI's members have a vital interest in the outcome of this case. Unrecovered—"trapped"—costs financially weaken utilities. This threatens the continued provision of one of the nation's most reliable and important energy resources by lessening the ability to purchase needed fuel, power, and equipment. If retail ratemaking authorities are permitted to evade explicit FERC allocation decisions, especially one which has only recently been affirmed by this Court, the ability of FERC to resolve allocation disputes will be destroyed. Electric utilities will thus be subjected to trapped costs with their potentially severe financial impacts whenever interstate allocation disputes arise. Therefore, EEI urges this Court to reverse the lower court's decision.

STATEMENT OF THE CASE

In view of the extensive Statement of the Case presented by NOPSI, and the fact that this Court has before been presented with the relevant FERC and Council orders, EEI will only briefly set forth the facts of this case. On behalf of the whole system, Entergy had one of its subsidiaries build Grand Gulf Station Unit No. 1 ("Grand Gulf"), a major base-load generating unit. The various operating companies each agreed to purchase part of Grand Gulf's output at wholesale for resale. The agreements governing these transactions were all filed at FERC for its review and approval.

FERC held lengthy and exhaustive proceedings concerning the allocation of Grand Gulf costs and just and reasonable rates for Grand Gulf power. During those

proceedings, the affected state and local jurisdictions participated fully and intensively. Each jurisdiction sought to minimize the share of Grand Gulf costs to be borne by its ratepayers. The City of New Orleans ("City") was an active participant. However, the City did not present—in fact, no party presented—a significant argument discussing the prudence of initiating or completing the Grand Gulf project.

After those proceedings, FERC determined that a just and reasonable wholesale rate for Grand Gulf power required a reallocation of costs to reflect system load responsibility.[3] NOPSI had been allocated 29.8% of Grand Gulf in the case as filed (*Middle South*, Initial Decision, note 3, *supra*). The City had argued that NOPSI's responsibility should be only 9% (*id.*). FERC determined that total system nuclear investment cost should be equalized, and so allocated 17% of those costs to NOPSI (*id.*).

Subsequent to FERC's decision, NOPSI sought authorization from the Council to recover its portion of the Grand Gulf costs through its retail rates. Ultimately, the Council disallowed $135-million of NOPSI's Grand Gulf costs. Shortly after the Council concluded its proceeding, this Court, in *MP & L*, enforced FERC's cost-allocation decision. At retail, this disallowance had virtually the same effect as would have occurred had FERC allocated Grand Gulf expenses to NOPSI in the 9% amount advocated by the City in the FERC proceedings.

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[3] *Middle South Energy, Inc.*, Initial Decision, 26 FERC ¶ 63,044 (1984), *aff'd*, Opinion No. 234, 31 FERC ¶ 61,305 (1985), *decision on reh'g*, Opinion No. 234-A, 32 FERC ¶ 61,425 (1985); *System Energy Resources, Inc.*, Opinion No. 292, 41 FERC ¶ 61,238 (1987); Opinion No. 292-A, 42 FERC ¶ 61,091 (1988). *See also Mississippi Indus. v. FERC*, 808 F.2d 1525 (D.C. Cir.), *vacated in part*, 822 F.2d 1104, *cert. denied sub nom. Arkansas Public Service Comm'n v. FERC*, 484 U.S. 985 (1987); *City of New Orleans v. FERC*, 875 F.2d 903 (D.C. Cir. 1989), *cert. denied sub nom. Miss. v. FERC*, —— U.S. ——, 110 S.Ct. 1805 (1990).

The Council held that NOPSI was "imprudent" during the construction period for failing to minimize the "losses" it should have anticipated as a result of FERC's rate determination and cost allocation (*e.g.*, J.A. 71-72, 170-171). This holding has the practical effect of requiring NOPSI to have expected an adverse FERC decision at the end of the construction period. The Council held that, given such a required expectation, NOPSI should, and could, have sold almost half of its Grand Gulf entitlement and responsibility, and purchased lower-cost electricity. *Id.* The Council never addressed the question of whether NOPSI could, under the system-wide contracts, have retained all of the hyopthetical benefit the Council was assuming that NOPSI could have acquired (*see id.*).

Significantly, FERC adopted the Administrative Law Judge's finding that Grand Gulf had been prudently constructed. 26 FERC at 65,112-113, *adopted*, 31 FERC at 61,666, *upheld*, 487 U.S. at 363. The City had never disputed that conclusion before FERC. *See MP & L*, 487 U.S. at 375. Thus, until after FERC's allocation and the Council's disallowance decision, NOPSI had no "losses" to mitigate.

On appeal, this Court ordered the U.S. Court of Appeals for the Fifth Circuit to hear this case in *NOPSI v. The Council of the City of New Orleans*, 491 U.S. 350 (1989) (the abstention doctrine of the Federal courts was not a sufficient basis for declining to hear this case) ("*NOPSI* III"). After *NOPSI* III, however, the Court of Appeals held that the Council's determination of imprudence was not "facially preempted" by FERC's opinion. The lower court reasoned that FERC had approved only the initial prudence of NOPSI's decision to participate in Grand Gulf. In fact, the lower court held that FERC did not assert jurisdiction to look at NOPSI's later prudence in continuing to participate once construction was "underway" (J.A. 25). Therefore, the lower

court concluded, *Nantahala* and *MP & L* did not preclude the Council from investigating NOPSI's ongoing prudence.

SUMMARY OF ARGUMENT

Only FERC can provide the neutral forum which is essential to the resolution of interstate disputes involving the allocation of costs among utilities operating in several jurisdictions. This Court has recognized FERC's central role in, and has applied the doctrine of federal preemption to, the context of electric utility regulation in order to ensure the continued existence of a coordinated regulatory structure. *Nantahala*, 476 U.S. 953; *MP & L*, 487 U.S. 354. However, the opinion of the court below violates this principle of preemption, endangering effective federal regulation of electric wholesale rates, in addition to threatening the financial health of electric utilities.

This Court should not countenance the Court of Appeals' failure to uphold a FERC allocation already reviewed and approved by this Court, any more than it can condone that action as taken directly by the Council. The Council's action is prohibited by *MP & L* and *Nantahala*. The Council's prudence argument is merely a transparent attempt to allow it to avoid or amend FERC's allocation. The City did not raise its argument before FERC when it had the chance—at least nine years after the commencement of construction. Further, during the retail rate proceeding, the Council did not engage in a truly separate evaluation of the prudence of any of NOPSI's overall practices such as, for instance, NOPSI's power supply. The Council merely repackaged the losing litigation position it had taken before FERC. The Court of Appeals decision must be reversed as not being in accord with *MP & L* and *Nantahala*, and the lower court must be instructed to overturn the Council's $135-million disallowance of NOPSI's Grand Gulf costs.

ARGUMENT

THE OPINION BELOW VIOLATES THE PREEMPTION DOCTRINE OF *NANTAHALA* AND *MP & L*, THREATENING THE PROPER AND WELL-ESTABLISHED RELATIONSHIP BETWEEN FEDERAL AND STATE/LOCAL ELECTRIC UTILITY REGULATION.

The Council's decision to disallow $135-million of NOPSI's Grand Gulf costs is prohibited by FERC's preemptive allocation of thos costs in the wholesale rate proceeding relating to Grand Gulf. Notwithstanding the erroneous conclusion of the court below, this Court's *Nantahala* and *MP & L* opinions make clear that the Council could not properly bar the recovery by NOPSI of any portion of the Grand Gulf costs FERC ordered NOPSI to pay. *Nantahala* and *MP & L* require that FERC's cost allocation be adopted by the Council as a prudent cost of power recoverable through NOPSI's retail rates.

FERC had already addressed many of the issues addressed by the Council, and those not addressed by FERC could have been raised by the City before FERC. The Administrative Law Judge addressed the prudence of Grand Gulf, and FERC adopted his findings (26 FERC at 65,112-113, *adopted*, 31 FERC at 61,666, *upheld*, 487 U.S. at 363). Under *MP & L*, this preempted any further discussion of the prudence of Grand Gulf construction.

The "prudence" argument of the Council in this case is no more to be given weight than the prudence argument was given weight in *MP & L*. Any other result would so undermine FERC's wholesale ratemaking authority as to render it a meaningless exercise any time there is a substantial interstate conflict—precisely contrary to the intent of Congress in passing the Federal Power Act. "The only appropriate forum for such a challenge is before [FERC] or a court reviewing [FERC's] order." *MP & L*, 487 U.S. at 375.

A. Under *Nantahala*, FERC's rate order triggered the principle of federal preemption, removing prudence from the Council's purview.

The lesson established by this Court in *Nantahala* is that a State's "historic police powers" do not permit a State commission to disallow a portion of a FERC-approved rate. Neither can a State avoid this prohibition simply by asserting that FERC's allocation had not been directly or indirectly attacked by the State's ruling. *See* 476 U.S. at 961-62. Thus, any attack on a utility's activities which have already been approved by FERC is an impermissible collateral attack on FERC's order.

In *Nantahala*, FERC had allocated low-cost TVA power between two affiliated power companies. 476 U.S. 961-62. The State commission later held that one of those utilities could have allocated more low-cost power to the other than was recognized by FERC's allocation. On that basis, in setting retail rates the State commission effectively disallowed recovery of a portion of the rate accepted by FERC, by assuming a higher allocation of low-cost power than that established by FERC. *Id.*

This Court recognized that the State's action would destroy FERC's ability to regulate wholesale transactions. The *Nantahala* Court held that "a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price." 476 U.S. at 965. This Court stated with crystalline clarity that

> a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate . . . . Such a "trapping" of costs is prohibited.

476 U.S. at 970 (citation omitted). Once FERC has established a rate and allocation, a State may not under any guise revisit the determination of that rate or allocation, or in any way prevent the recovery of those costs.

B. *MP & L* reiterates the *Nantahala* prohibition of the Council's "prudence" review of NOPSI's practices.

The Council's position in this case is based on the holding that NOPSI at one and the same time could have been prudent—as found by FERC—to have obtained 17% of Grand Gulf through to the completion of that plant, but to have been imprudent—as found by the Council—in failing to sell a large portion of that share at some point during the plant's construction period. Such a position is contradictory in the least. Moreover, with the issue of Grand Gulf prudence having already been addressed by FERC through its Administrative Law Judge, it is too late to make such an argument.

In *MP & L*, the State supreme court had held that the State commission could review the prudence of the utility's management decisions regarding Grand Gulf. 487 U.S. at 368. One of the arguments in support of that position had been that the FERC opinion had never explicitly addressed prudence. *Id.* However, this Court rejected that line of reasoning as simply being another collateral attack on FERC's "plenary authority over interstate wholesale rates":

> Just as Nantahala had no legal right to obtain any more low cost TVA power than the amount allocated by FERC, it is equally clear that MP & L may not pay for less Grand Gulf power than the amount allocated by FERC.

487 U.S. at 374. The *MP & L* Court found that the investigation of Grand Gulf prudence was an impermissible collateral attack on FERC's order—the issue of prudence had been before FERC, and was therefore preempted by FERC's allocation of Grand Gulf costs. 487 U.S. at 374-375.

FERC's decision on the Grand Gulf prudence issue must be the sole, final and binding decision. The *MP & L* Court firmly stated that the

> reasoning that led to our decision in *Nantahala* applies with equal force here and compels the same conclusion—States may not alter FERC-ordered allocations of power by substituting their own determinations of what would be just and fair.

487 U.S. at 371. "States may not regulate in areas where FERC has properly exercised its jurisdiction . . ., without traversing matters squarely within FERC's jurisdiction." 487 U.S. at 374, 376.

It was improper for the Council to evaluate the prudence of NOPSI's continued participation in Grand Gulf. This case involves the very same generating plant and the same set of owners as in *MP & L*. And, just as in *MP & L*, the prudence review in this case was restricted by its own terms to Grand Gulf matters. Other prudence matters which may legitimately have been addressed by the Council were dealt with entirely separately.

As the *MP & L* Court said, the retail ratemaking body "may not enter an order 'trapping' the costs . . . mandated . . . under the FERC order allocating Grand Gulf power[,] or undertake a 'prudence' review for the purpose of deciding whether to enter such an order." 487 U.S. at 372. *MP & L* established that FERC has decided, and thereby preempted, the Grand Gulf prudence issue. Thus, there is nothing left for the Council to decide on that matter in this case.

C. *Nantahala*'s limited exception to FERC preemption simply does not apply in this case.

The limited exception to FERC preemption which can be found in *Nantahala* does not and cannot be utilized in this case. In *Nantahala*, this Court noted that "an increase in FERC-approved wholesale rates need not lead to an increase in retail rates" on a one-for-one basis, as the utility may have experienced cost "savings in other areas" not regulated by FERC. 476 U.S. at 967-968 (citation omitted). In this case, the Council's order did

not address any area other than that already preemptively addressed by FERC. Moreover, this Court has never held that the type of speculative retroactive ratemaking engaged in by the Council was equivalent to a cost-reduction recognizable under the *Nantahala* exception.

The sales required by the Council of NOPSI to reduce its costs were purely hypothetical in two ways. First, there has been no showing that NOPSI could have retained all of the benefit of such sales. In fact, there is every reason to conclude that NOPSI could not have retained the entirety of such a benefit. *See* 26 FERC at 65,148-149; J.A. 42-43, 49. Absent such a showing, it is inappropriate to attribute any portion, much less the entirety, of the benefit of these hypothetical transactions to NOPSI.[4]

Second, the Council's disallowance rests upon factual assumptions directly contrary to those made by FERC. The Administrative Law Judge found that the system reasonably concluded that all alternative sources of power were more expensive, and FERC adopted his conclusions. 26 FERC at 65,112-113, *aff'd*, Opinion No. 234, 31 FERC at 61,654-656. The Council, on the other hand, found that NOPSI could have obtained lower-cost power. Such a direct contradiction of a finding made during the course of a FERC wholesale proceeding cannot possibly result in the type of offsetting cost reduction referred to by this Court in *Nantahala*, at the very same time the Court also held that States could not relitigate issues decided before FERC, and that retail rate orders could not result in "trapping" FERC-approved costs.

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[4] The "evidence" upon which the Council relied in determining that there was an actual market for the Grand Gulf power the Council found NOPSI should have sold is not at all solid. *See* J.A. 71-72, 96-97.

D. FERC is the only appropriate forum for the resolution of interstate cost allocation issues.

Only FERC can provide the neutral forum which is essential to the resolution of interstate disputes involving the allocation of costs among utilities which operate in more than one state. This Court has recognized FERC's central role in, and has applied the doctrine of federal preemption to, the context of electric utility regulation to ensure the continued existence of a coordinated regulatory structure. *See Maine Public Utilities Comm'n v. Maine Yankee Atomic Power Co., cert. denied,* —— U.S. ——, 59 U.S.L.W. 3527 (No. 90-1194, June 24, 1991) (*"Maine Yankee"*) However, the opinion of the court below violates this principle of preemption by allowing unlimited State and local attacks on FERC-approved rates and allocations, such as was demonstrated in *Maine Yankee.* This endangers effective federal regulation of electric wholesale rates and threatens the financial health of electric utilities, thereby threatening the health of the nation's economy, as well.

Conflicting regulation resulting from State or local jurisdictions not agreeing to share all of the wholesale costs of electric energy and capacity will result in such costs not being recovered by utilities. Such "trapped" costs financially weaken utilities by seriously disrupting cash-flow and harm a utility's financial ratings, reducing a utility's ability to attract reasonably-priced capital, by reducing earnings and shaking investor and lender confidence in the assuredness of their return.

Initially, rates may stay lower, but in the long run, they will only increase. It was to prevent just such a short-sighted parochial form of regulation that Congress established the Federal Power Act giving FERC its plenary authority over wholesale electric rates. EEI stresses that the stable regulatory structure provided by federal regulation of interstate wholesale rates is better for the industry and thus, given the importance of elec-

tricity as an essential component of the country's infrastructure, better for the nation's overall economy.

CONCLUSION

This case is completely within the bounds of the issues settled by *MP & L* and *Nantahala*. Therefore, the decision of the Court of Appeals should be reversed, and this Court should direct the lower court to overturn the Council's $135-million disallowance of NOPSI's Grand Gulf costs.

Respectfully submitted,

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